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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1963.

CHARLES ORAN MENSIK and
MARY MENSIK,

*Petitioners,*

*vs.*

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

## REPLY BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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## REPLY TO RESPONDENT'S BRIEF IN OPPOSITION TO THE PETITION.

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The Respondent's brief in opposition to the petition for the Writ of Certiorari contains a new theory by which Respondent seeks to justify the finding of the Tax Court that the Petitioners had taxable income as a result of the loan by Melvin Building Corporation to one Orville E. Hodge. Both the Tax Court and the Court of Appeals made "favors received or to be received" by the male Petitioner from Orville F. Hodge of no determinable monetary value or no value at all, the conjectural measure of tax liability and fraud penalties. Now Respondent argues:

> "Petitioners' contentions (Pet. 11-15) that he realized only Hodge's "favors" as a result of these transactions and that he personally received no part of those 'loans' misapprehend the basis of the Tax Court's findings. *It is because Petitioner fully controlled the disposition of the [illegible] payments made to Melvin that such amount*

*was taxable to him.*" (Resp. br. p. 7) (Emphasis supplied.)

With this as a keystone, Respondents' brief then weaves threads of suspicion and theory and presents them as the cloth of fact. For these reasons, Petitioner deems a reply necessary. Parenthetically it should be noted that the entire history of the cause is one of shifting theories by the Internal Revenue Service and government attorneys, when answered by petitioners to alternative bases with consequent deprivation of *due process* to the Petitioners.

The starting point of this assessment against Petitioner is set forth in the original 90 day letter statutory notice of deficiency as follows:

> "Payments to you, or for your benefit by City Savings Association and Melvin Building Corporation in the total of $327,824.04."

Listed in this total as item C was the specific item in the amount of $176,312.50.

In preparation for trial, the attorneys for petitioners separately discussed this specific item of $176,312.50 with government counsel for Respondent. In reliance upon statements of government counsel . . . "You won't have to bring him in. We're not contesting that payment was made by Melvin to Hodge. . ." (See affidavits R. pp. 129 and 130) the attorneys for petitioners thereupon abandoned their thought of requesting subpoena for Hodge. On the day of trial Respondent shifted his position and filed amendment to pleadings changing this specific item from $176,312.50 to $206,330.16. In answer to petitioners' objection to this new theory, government counsel argued (Tr. 25):

> "*Exactly how he got his money out of Melvin, we cannot show* precise amounts, of course, and dates. We

> have a number of instances which we *think* could very well constitute his taking money out of Melvin. One of them was a loan by Melvin to Orville E. Hodge, who is now in prison, the State Auditor who was a friend and benefactor of Mensik's; *and that was used in the 99 day letter as the measure of the misappropriation from this job.*" (Tr. 33) (Emphasis supplied)

The Tax Court overruled petitioners' objection and allowed the amendment, in derogation of petitioners' right to have sufficient time and opportunity to meet Respondent's new theory of the case. It is to be noted that the case was submitted on the amended theory just five days later on June 29, 1959 when Judge Bolon B. Turner took final submission of the case. A year and one half later the Tax Court rendered its decision and in rejecting the amendment fell back on the presumption of correctness of the original statutory notice of deficiency, this, despite conceded error and inaccuracies of more than 60 per cent of the amounts assessed—being more than $500,000.00 of the asserted tax and penalty.

> The errors and inaccuracies of this notice of deficiency included: an arbitrary disallowance of petitioners' payments of interest on personal loans in the amount of $11,308.10.
>
> The petitioners' payments of real estate and sales taxes in the amount of $1,440.92, including local real estate taxes on the home in which petitioners live.
>
> Charitable contributions made by petitioners totalling $2,380.00.
>
> An assessment of $1,30,416.36 as income on monies borrowed by Petitioners from the Chicago National Bank and the Oak Park National Bank upon which petitioners were paying interest.
>
> A disallowance of all original purchase cost of $49,567.66 for real estate which was sold during the pertinent year.

Disbursements from an escrow account in the amount of $60,000.00 charged as income to petitioners.

Denial of business travel expense by male petitioner in the amount of $4,614.63.

An Allied Investment Company check in the amount of $70,096.91 charged as income to petitioners."

It was not until one year after the proceedings were commenced that the Commissioner Respondent conceded error to all the above items and so stipulated in the Tax Court.

The decision none the less was bottomed on "favors received or to be received." (R. 94). After the Tax Court's decision a petition for rehearing was filed and petitioners sought to bring in the witness Hodge having thus learned that the question of "favors" governed the Tax Court's decision. This was crucial because the language of the Tax Court (R. 94), "*We do not know what the full and true story is with respect to the payments by Melvin to Petitioner in 1956*" . . . and "*what the arrangement was between Petitioner and Hodge, we do not know*" . . . is an outstanding admission that the Court itself had not resolved the very issues upon which it rested its decision that petitioners were in receipt of unreported income in the amount of $176,312.50. In the view taken by the Tax Court Judge of this aspect of the case, Hodge's testimony was vital. To refuse the petitioner's right to call this witness was not a mere exercise of discretion but serious and substantial error and petitioners were thus denied *Due Process of Law*.

The history of this cause reflects a continuous slanting of evidence to meet new theories when answered by petitioners to justify assertion of tax by the Commissioner of Internal Revenue against petitioners for the $176,312.50 transactions between the Melvin Corp. and Hodge. For a time "favors" was the basis. Now at this stage of the litigation Respondent adopts a new theory.

The Respondent's present position: "It is because petitioner fully controlled the disposition of the overpayments made to Melvin that such amount was taxable to him." is found in the Respondent's brief at page 7. This statement is followed in the next sentence by the confusing assertion: "the fact that the money was paid to Hodge, possibly, as the Tax Court observed, in exchange for "favors" done on Petitioner's behalf—did not prevent it from being income to petitioner; nor did it make the value of the "favors", rather than the "loans, the actual measure of petitioner's gain from these transactions." The reason for this constant shifting is obvious. The Respondent and the Courts below do not say why money from Melvin to Hodge is income to the petitioners, other than by arbitrary declaration. The Melvin Building Corporation reported this income from the City Savings Association remodeling job and paid tax on the income. Melvin Building Corporation made loans to Hodge of $176,312.50 yet the Commissioner has assessed this same item as income to Hodge. This same item, to the penny, is here being assessed against these petitioners as income to them, therefore the petitioners must continue to assert that they will be deprived of property *without Due Process of Law* by the flow and ebb of the governmental processes.

The fact recitation by the Respondent contains some major inaccuracies:

Inaccuracy No. 1: (Resp. br. p. 3)

> "* * * petitioners' relatives and other associates, * * *, took instruction from petitioner regarding the conduct of Melvin's business."

Correction:

The record does not bear this out. Respondent has cited several record references (R. 35-39, 82). The pertinent portions, thus referred to, upon closer examination do not justify such a conclusion. The Tax Court actually said:

> "In transactions in which petitioner had an interest directly or indirectly and with which Carl Melberg, Kramer or Mary Ann Barto were involved or concerned, they were subservient to petitioner, and where Melvin was a party to such transactions, petitioner, to a substantial degree, determined and directed the manner of their treatment on Melvin's books."

If it was conceived for argument purposes that petitioner C. Oran Mensik *did* "to a substantial degree, determine(d) or direct(ed)" the manner of their treatment on Melvin's book," then it must be remembered in this connection that Melvin did report this *total* income and its source and paid income taxes. This is unquestioned, it is a construction of disbursement of loans that is questioned.

Respondent would have this Court believe that petitioner was actually running Melvin's business. The number of times when he was consulted in no way justify the Respondent's conclusion of constancy. On such occasions Melberg, the President of Melvin; was *always* present and the clear and correct interpretation to be given these conferences is that petitioner's advice on financial matters was frequently sought on extra work done.

There is no evidence that petitioner imposed himself upon the conduct of Melvin's business. The brief of the Respondent also refers to p. 82 of the record. Reference to that record shows that the Tax Court said:

"As between petitioner and Melvin, the record shows that Monsik was likewise in a position of dominance, and where his personal interests were concerned, that he did dominate."

This is a far cry from the Respondent's assertion that the male petitioner directed and instructed regarding the conduct of Melvin's business.

Inaccuracy No. 2: (Resp. br. p. 4)

"Petitioner instructed Melvin's accountant to add additional fictitious costs to the remodeling job and to alter the records so as to reflect the total cost to Melvin as $256,207.26, instead of an actual cost of $115,397.71."

Correction:

No actual cost was established. The record fully discloses the Tax Court's confusion on this point. There is a concession that added costs increased the original estimate. (R. 70-72).

It is significant that the Respondent's brief makes no record citations to the direct examination of government witness Joseph W. Bagnuola, the independent architect who prepared the original plans for the City Savings Association remodeling. This testimony (Tr. 427-446) clearly explains the reasons for the disparity between the original estimate of the job ($125,000.00) and the final payments by City Savings Association to Melvin of $367,800.00. Many additional changes had to be made as work progressed and

additional charges not contemplated at the time the original plans were made.[1]

It is also significant that this government witness also testified, in detail, to the many items not included in the original estimate of $125,000.00 (the amount referred to by respondent at page 6 of the brief in opposition to review). These items were substantial:

> In connection with the original estimate of $125,000.00, the architect when examined by the government attorney for the Internal Revenue Service stated that air-conditioning on the second floor to all rooms, was not included (Tr. 434).
> Cement sponge base and rubber tiling for flooring on the second floor. Not included (Tr. 435).
> Heating for second floor. Not included (Tr. 435).
> Reinforcement of roofing (which architect estimated as an additional $10,000.00 cost for this one item. Not included (Tr. 436).

[1] (Tr. p. 431) A. Yes. I was called in on many occasions due to the structural findings of the building. In any re modeling job, there are always hidden factors that we cannot anticipate until we open up the construction features. And in one instance, I was called in to redesign the roof structure of the west portion of the second floor addition because the partition walls which were constructed were supporting walls; and when we removed them, the joists were sagging. And additional steel had to be inserted in order to re-enforce the roof structure. There were about six or seven beams involved. We had to design the beams. These beams had to be inserted in the walls and the roof had to be shored up so the beams would fall in line with them there.

We were also called in on another instance on the elevator shaft. The existing masonry wall which is a bearing wall that is supporting a four story building—I believe it is three or four stories—and the foundation is constructed of rubble stone which indicated the building was at least fifty years old or more. We had to undermine underneath the existing wall and privide shoring and additional footings in order to install this elevator.

Painting on second floor. Not included (Tr. 439).
Installation on cel-o-tex ceilings on second floor. Not included (Tr. 439).
While the bank was operating during normal business days payment of overtime for evening work and Sunday work. Not included (Tr. 439).
Terraza floor on the main floor of the bank. Not included (Tr. 441).

These and many other changes in the remodeling job made it necessary for the male petitioner in his capacity as an officer of the City Savings Association to meet with Mr. Carl M. Melberg, President of the Melvin Building Corporation on many occasions. It was also necessary for Mr. Mensik to meet with the accountants of the Melvin Building Corporation, particularly Mr. Leon Winterhalter of Burlingame and Company, Certified Public Accountants with offices in Chicago and St. Louis. Further in connection with the alleged entries in the Melvin books it is to be noted that the record is clear that whenever Mr. Mensik conferred with the bookkeeper, Mr. Melberg was also present. The inference drawn by the Tax Court that Mr. Mensik directed entries to overstate the true profit is unfounded in this record.

Reason dictates that the male petitioner did not control or dominate the book entries made by the Melvin Building Corporation and the practices of this accounting firm. In view of the clear requirement that to assess fraud penalties there must be a clear and convincing showing of "fraud" that burden simply was not met nor established in this case. The piling of inference upon inference or inferring that circumstances are suspicious has given rise to comment by many courts. We submit the following language of the United States Court of Appeals, Second Circuit, to be particularly appropriate here:

> "When it comes, however, to his proof on the issue of fraud, where the burden lay on the commissioner, we think that it fails as proof for lack of evidence of a starting or an ending point. While it is true that the taxpayers proof and attitudes, not only in this matter but in matters where she came in conflict with the Office of Price Administration, was not satisfactory, this did not supply the deficiencies in the commissioners proof, which, despite his contention here to the contrary, consisted of little more than the fact that he had determined the deficiency claimed. The case on the issues where the burden was on the commissioner was presented and tried too much on the theory, 'Give a dog an ill name and hang him'." *Olinger* v. *C.I.R.*, 5 Cir., 234 F. 2d 823, P. 824.

The constant repetitive use of "the petitioner" by the government and the lower courts shows the *pro forma*, casual, and arbitrary failure of consideration to the position of Mary Mensik, *Petitioner*. The title of the case emphasizes this error.

Mary Mensik only signed the return as a spouse with reliance on accountants and her husband. Not a scintilla of evidence indicates her participation or knowledge of these transactions of her spouse, in any matter covered by the record. How can it be conceived under this record of evidence that the Commissioner respondent, has proved clearly, or at all, that she had the mental attitude of fraud. If she was negligent, at worst, it is arbitrary deprivation of *due process* to brand this lady with fraud on this record.

Inaccuracy No. 3 (Resp. br. p. 4):

> "Orville Hodge, Auditor of Public Accounts of the State of Illinois charters to some of the financial institutions controlled by the petitioner and retro-

actively approved the investment of 10 to 15 per cent of these institutions assets in their own buildings, under a provision of the Illinois law which requires as such investment in excess of 5 per cent to be approved by the auditor."

Correction:

Note: This correction brings the petitioners to another assignment of error below. It has been contended that when the Tax Court refused to grant the petition for rehearing, the petitioners were denied due process. The truth was also suppressed. The government says in its brief here that Hodge's testimony "could not effect the result it reached" (Resp. br. p. 8). This ignores the real basis for imposing upon petitioners a tax on $176,312.50 received by Hodge from Melvin. The inaccuracy stated above is prelude to establishing a *quid pro quo* for the loans by Melvin to Hodge and taxed to the petitioners. Testimony by Hodge fortunately is a matter of record here. It takes two forms. The first is a Q and A taken by Intelligence Agents of the Internal Revenue Service from Hodge on November 13th, 1958, after he was incarcerated in the Illinois State Penitentiary at Menard, Illinois (R. 115-122). The other is an affidavit by Hodge given while still in the penitentiary on March 30th, 1962. (R. 127-9)

Hodge, in addition to swearing on both occasions that he received the $176,312.50 and used it in the construction of his Esquire Hotel in Florida, states several items of crucial importance to the issues before the Tax Court:

Q. New buildings were erected on the sites acquired. One on North Ashland Avenue and the other on North Avenue in Chicago. These buildings were completed about July of 1956. It appears that the costs were much in excess of allowable expendi-

tures for construction based on deposits. Did you approve the excessive costs on these buildings.

A. I had nothing to do with that department whatsoever and I didnt even know they had two buildings. (R. 121)

It should be clear that "excessive costs" as here used does not refer to cost of construction of the buildings which were later sold for book value.

And, again on the subject of "favors":

Q. Could these so-called loans have represented a consideration of any favor that you may have granted Mr. Mensik or his association?

A. I never gave Mr. Mensik any more favors than I gave any other loan associations in Chicago or the State of Illinois. (R. 122)

In his affidavit Hodge stated:

"Your affiant states that, if he were unable to pay back the $176,312.50 to Melvin Building Corporation within the year, affiant intended to issue a second mortgage to Melvin Building Corporation on the Esquire Hotel in Miami, Florida. Affiant states that the said hotel, in affiant's opinion, was worth at least $700,000.00, and that, at a forced sale, and under peculiar circumstances, it was sold for $575,000.00. Affiant felt that a total mortgage of the amount of $376,312.50 was an amount well within the actual value of the said property.

Your affiant regarded the loan from Melvin Building Corp. as a pure business deal, and your affiant, in his private and official capacities, did no favors for C. Oran Mensik in return for the loan of this money, or any other monies." (R. 128)

The mortgage referred to by Hodge, of course, INCLUDED THE $176,312.50 LOANED HODGE BY MELVIN.

The Tax Court ignored this plain testimony which clearly corroborated the petitioners' evidence. No evidence to the contrary was adduced by the Respondent. The "theory" of the Internal Revenue Service has been accepted by the Tax Court in lieu of sworn testimony. To reject it or ignore it under the circumstances was error and a deprivation of *due process of law.*

Aside from the fact that the Tax Court has attacked the rate of profit earned by Melvin, for the remodeling, the Tax Court further found that the contract was so awarded "with the deliberate purpose of providing funds for the payment" by Melvin to a former public official, one Orville Hodge. The first loan to Hodge was made by the Melvin Building Corporation on 3/12/56 for $76,312.50, more than six months after the original remodeling contract was executed and the balance of the sum in question, $100,000.00, was loaned on June 29, 1956, nine months after the building contract was executed by the officers of City Savings and the directors of said mutual Ass'n. How ca nany presumption be drawn that the contract was entered into as a means of providing funds to Melvin so as to make payments to a state official, when there is a lapse of 9 months between both events? The inference of the Tax Court that since payments were mad. by City Savings Assn. to Melvin Building Corp. in amounts similar to the amounts of the loans to Hodge was not just *coincidence*, can hardly be a sound basis upon which to sustain imposition of fraud penalties in excess of $100,000.00.

At Page 6 of the governments brief it is argued, "Thereafter, funds were funnelled from Melvin on petitioners instructions." Funnelled to whom? The record clearly shows it was Hodge who received the money and exe-

cuted three judgment notes to secure repayment and yet the commissioner now stands on the proposition (Page 8 Respondent's brief), that the "Tax Court found that petitioner was to "be the *ultimate* recipient." The record is void of showing that Petitioners received a single penny of this money.

The Respondent cites *Helvering* v. *Horst*, 311 U.S. 112, in support of its position. This case is inopposite to the facts here and concerns the gift of negotiable interest coupons not then due, from father to son. This was property held by the Father *as a matter of right* and the sole question as stated by this court at page 114 was:

> "The sole question for decision is whether the gift, during the donor's taxable year, of interest coupons detached from the bonds, delivered to the donee and later in the year paid at maturity, is the realization of income taxable to the donor."

It is respectfully submitted that the record in the instant case shows that the court below departed from established principles of decision in finding that petitioners *realized gain* upon which income tax can be properly asserted and that the Respondent failed in its burden to establish fraud. For the reasons stated hereinabove the petitioners respectfully seek relief from this court.

## CONCLUSION.

Respondent's brief opposing review fails to meet petitioners' contentions. Petitioners seek certiorari to review all issues decided by the lower court. It is respectfully submitted that substantial issues are involved which include *due process of law* as guaranteed by the Constitution of the United States to all of its citizens and that the lower court in adopting the opinion and findings of the Tax Court "in all respects", so far departs from the usual course of judicial proceedings and established principles of decision as to call for an exercise of this Court's power of supervision.

Respectfully yours,

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